APPENDIX A

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

Alexandria Division

[FILED OCT. 16, 1972]

Civil Action No. 236-71-A

GEORATOR CORPORATION, *Plaintiff*

v.

UNITED STATES OF AMERICA, *Defendant*

Memorandum Opinion and Order

The question here is whether the attorney fees and expenses paid by the plaintiff in defending the suit seeking to cancel its trademark registration are capital expenditures or ordinary and necessary business expenses.

The facts are not in dispute—The plaintiff acquired the common law exclusive right to the trademark in question prior to 1952—It was registered in the United States Patent Office on March 10, 1964, valid for the customary statutory period of twenty years, subject to renewal for an additional period.

Wincharger Corporation, a subsidiary of the Zenith Corporation, filed a petition in the Patent Office to cancel the registration under 15 U.S.C. § 1064(c). The petitioner did not challenge or contest [2] any substantive rights of the plaintiff in the trademark and specifically did not challenge the plaintiff's title to the trademark nor the validity thereof, nor the plaintiff's entitlement to use the same.

After protracted and costly proceedings, the Patent Office dismissed the petition because the Wincharger Corporation had failed to adduce any substantial evidence to refute the presumptions afforded the involved registration.

Dismissal by the Patent Office does not bar or estop any qualified person from again filing a petition to cancel upon the same grounds for removal of the plaintiff's mark from the principal registry.

Although § 162(a) of the Internal Revenue Code allows a deduction for all necessary expenses paid in carrying on a trade or business, the Government contends the expenses and legal fees here claimed are not deductible as such because § 263(a)(1) of the Internal Revenue Code denies deductions for any amounts paid for permanent improvements or betterments made to increase the value of any property or estate—The Government says the expenses here claimed increased the value of the plaintiff's registered trademark.

This conclusion on the part of the Government lacks support in both fact and law.

In the case at bar the plaintiff was not in a better position after the contest—It was in a [3] worse position—The scope of its registration was limited—Clearly, the value of the trademark was not enhanced.

Trademark rights are acquired by use or appropriation and registration alone does not increase the scope of such substantive rights. See Huber Baking Company v. Stroehmann Bros. Co., 252 F.2d 945 (2nd Cir. 1958). Registration confers only procedural rights, such as the right to invoke the jurisdiction of federal courts regardless of diversity and the amount in controversy.

A lawsuit necessarily implies the employment of counsel and the payment of his charges. Defending the cancellation proceeding was necessary and proper.

The costs ought to be deductible as ordinary and necessary business expenses, and

It Is So Ordered.

The Government seeks to buttress its contention that these expenditures should be capitalized by citing § 263 of the Internal Revenue Code, § 1.263(a)-3(b)(4), which grants the taxpayer an election to either deduct or capitalize trademark expenditures which are directly connected with the acquisition, protection, expansion, registration or defense of a trademark. (See §§ 177 and 177(b) of the Internal Revenue Code.)

[4] These sections of the Internal Revenue Code are not applicable to this case for several reasons—First, the plaintiff has made no election; and second—and more importantly—the expenditures here claimed were not connected with the acquisition of the registration or the validity of the trademark—They were incurred in defending a cancellation proceeding.

Had the Court agreed with the Government that these expenses should have been capitalized—the Government says they cannot now be capitalized because the taxpayer failed to timely elect to so do—This to me is untenable.

The plaintiff is entitled to a refund of the taxes erroneously collected. His counsel will prepare an appropriate order so decreeing, submit it to counsel for the Government for approval as to form, and then to the Court of entry.

The Clerk will send a copy of this memorandum opinion and order to all counsel of record.

October 16, 1972

/s/ Oren R. Lewis
United States District Judge

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 73-1187

GEORATOR CORPORATION, *Appellee*,

v.

UNITED STATES OF AMERICA, *Appellant*

Appeal from the United States District Court for the Eastern District of Virginia, at Alexandria. Oren R. Lewis, District Judge.

Argued: June 4, 1973

Decided: October 2, 1973

Before WINTER, BUTZNER and FIELD, Circuit Judges.

Ann Belanger, Attorney, Tax Division, United States Department of Justice, (Scott P. Crampton, Assistant United States Attorney General, Meyer Rothwacks and Ernest J. Brown, Attorneys, Tax Division, United States Department of Justice, and Brian P. Gettings, United States Attorney, on brief) for Appellant; Mark P. Friedlander (Harry P. Friedlander, Friedlander, Friedlander and Brooks on brief) for Appellee.

FIELD, Circuit Judge:

This case presents the question whether for federal income tax purposes fees incurred while resisting a petition to cancel registration of a trademark may be deducted annually as an ordinary business expense or must be treated as a capital expenditure.

In 1964 Wincharger Corporation, a subsidiary of Zenith Corporation, filed a petition in the Patent Office to cancel Georator Corporation's (Georator) registration of the trademark "NQBRUSH" on the ground that the trademark had become the common descriptive name for certain types of electric generators and motors. After four years of litigation the Patent Office dismissed the proceeding because of the petitioner's failure to present any substantial evidence to refute the presumptions afforded the trademark by virtue of its registration.

In the course of defending its trademark registration, Georator incurred legal fees in excess of $18,000. These expenses were deducted annually as ordinary business expenses under Section 162(a) of the Internal Revenue Code, 26 U.S.C. § 162(a). Upon audit the Internal Revenue Service held the legal fees to be capital expenditures and determined an income tax deficiency for the years in question in the amount of $9,967.15. Georator paid the deficiency, petitioned for a refund and upon denial thereof brought suit against the government in the district court to recover the amount paid on the deficiency assessment. The district court agreed with Georator's contention that the legal fees were ordinary business expenses fully deductible in the years incurred and ordered that the deficiency, with interest, be refunded. From that judgment the government has appealed.

Our analysis of this question begins with the principle of taxation reflected in Section 162(a) of the Internal Revenue Code that an expenditure securing benefits which are

realized and exhausted in the same tax period is fully deductible in that tax period. Conversely, an expenditure securing benefits beyond the taxable year must be capitalized. *Darlington-Hartsville Coca-Cola Bot. Co.* v. *United States,* 393 F.2d 494 (4 Cir. 1968); *Richmond Television Corporation* v. *United States,* 345 F.2d 901 (4 Cir. 1965).

It is clear that an expenditure need not be for a capital asset, as described in Section 1221 of the Code, 26 U.S.C. § 1221, in order to be classified as a capital expenditure. Expenditures for equipment used in a trade or business and qualifying for the depreciation allowances of Section 167 of the Code, 26 U.S.C. § 167, while specifically excluded from the provisions of Section 1221, nonetheless constitute capital expenditures. Nor is it necessary that an expenditure increase the value of an asset in order to be classified as a capital expenditure, as the district court apparently assumed. Costs of defending title to property, although adding nothing to the value of the property, have been held to be capital expenditures. *Garrett* v. *Crenshaw,* 196 F.2d 185 (4 Cir. 1952); *Bowers* v. *Lumpkin,* 140 F.2d 927 (4 Cir. 1944). It is also clear that Section 263 of the Code, 26 U.S.C. § 263, which disallows deductions for expenditures which increase the value of any property, does not provide a complete or exhaustice list of nondeductible expenditures. *Commissioner* v. *Lincoln Savings & Loan Assn.,* 403 U.S. 345, 358 (1971).

Registration of a trademark in the Patent Office, while not enlarging the common law rights of a trademark, does confer very real benefits upon the holder of such trademark. Those benefits include: (1) constructive notice of the registrant's claim of ownership of the trademark; (2) prima facia evidence of the validity of the registration, of the registrant's ownership of the mark, and of his exclusive right to use the mark in commerce as specified in the certificate; (3) the possibility that, after five years, registration will become incontestible and constitute conclusive evi-

dence of the registrant's right to use the mark; (4) the right to request customs officials to bar the importation of goods bearing infringing trademarks; (5) the right to institute trademark actions in federal courts without regard to diversity of citizenship or the amount in controversy; and (6) treble damage actions against infringing trademarks and other remedies. 15 U.S.C. § 1051, et seq. Registration is effective initially for twenty years, but the possibility of renewal at the end of that time makes a determination of the effective life span impossible. Since the benefits of trademark registration are of indeterminate duration and likely to extend over several tax periods, the costs of registration have been held to be capital expenditures. *Dusenberg, Inc. of Delaware,* 31 B. T. A. 922 (1934); *aff'd on other grounds,* 84 F.2d 921 (7 Cir. 1936); see also our discussion of Section 177 of the Internal Revenue Code, 26 U.S.C. § 177, *infra.*

In our view, legal costs incurred resisting cancellation of a trademark registration must be treated in the same manner as the costs of the original registration. Plainly, successful opposition to a cancellation proceeding secures the benefits of registration as much as does the original registration of the trademark. The fact that dismissal of a cancellation petition is not *res judicata* does not alter the fact that the benefits of registration have been protected and preserved at least temporarily. If anything, successful opposition to a vigorous challenge will ordinarily deter all but the frivolous from future attempts at cancellation and, as appellee has noted, it is the realities rather than the formalities which must be given weight in tax litigation. Of significance here is the fact that the benefits of successful opposition to the cancellation petition were likely to extend, and in fact did extend, beyond the tax period in which they were secured.

However, our decision does not depend entirely upon this analysis. Under Section 177 of the Code, 26 U.S.C. § 177,

the owner of a trademark may elect to deduct over a period of not less than sixty months "any trademark or trade name expenditure." The Senate Report[1] accompanying Section 177 stated that

> "Under present law, expenditures paid or incurred by smaller companies in connection with trademarks and trade names, such as legal fees, are not deductible but must be capitalized.

In *Danskin, Inc.* v. *Commissioner*, 331 F.2d 360 (2 Cir. 1964), in which the legal costs of an infringement action were held to be capital expenditures, the court noted the Congressional desire to effect a measure of equity between large corporations which could deduct the salaries of staff attorneys and smaller corporations which were required to capitalize such legal expenses, but also observed that "if the expenses of trademark litigation were intended by Congress to be classified as ordinary business expenses under section 162(a) of the Code, it would hardly have been necessary to provide in section 177 a special rule covering them, a rule less advantageous to a taxpayer than section 162(a)" Id. at 362. Thus, unless the legal expenses of trademark cancellation proceedings are excluded from Section 177, a strong inference may be drawn that such expenses are capital in nature.

"Trademark or trade name expenditures" are defined in Section 177(b) of the Code as "any expenditure which: (1) is directly connected with the acquisition, protection, expansion, registration (Federal, State or foreign), or defense of a trademark, trade name, (2) is chargeable to capital account; and (3) is not part of the consideration or purchase price paid for a trademark, trade name or business." The district court held this section inapplicable to this case because "the expenditures here claimed were

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[1] S. Rep. No. 1941, 84th Cong., 2d Sess., p. 8 (1956-2 Cum. Bull. 1227, 1232).

not connected with the acquisition of the registration or the validity of the trademark—they were incurred in defending a cancellation proceeding." We find this to be an incorrect reading of Section 177. That section does not refer to expenses incurred in connection with the "acquisition of registration;" rather, it refers to expenses incurred in connection with the "acquisition * * * of a trademark," or in connection with the "registration * * * of a trademark." No reason appears in the language of the statute to distinguish between costs of the original registration and costs of the original registration and costs of a cancellation proceeding. Assuredly, costs incurred resisting a cancellation petition are "directly connected with * * * registration * * * of a trademark."

Concededly, some ambiguity as to the scope of Section 177 has been occasioned by the Treasury Regulations interpreting that Section. 26 CFR 1.177-1(b)(1) provides that

> "Generally, section 177 will apply to expenditures such as legal fees and other costs in connection with the acquisition of a certificate of registration of a trademark from the United States or other government, * * * litigation expenses connected with infringement proceedings, and costs in connection with the preparation and filing of an application for renewal of registration and continued use of a trademark."

Arguably, the failure to specifically include legal fees incurred in cancellation proceedings may be said to imply that such fees are not covered by Section 17 since, as appellee urges, they are not "chargeable to capital account." As noted earlier, however, the express language of the statute does not require such a narrow reading. Moreover, Revenue Ruling 55-158 [2] suggests the opposite construction. In order to avoid automatic cancellation of a trademark registration after six years, 15 U.S.C. § 1058 requires a

[2] 1955-1 Cum. Bull. 319.

registrant to file by the end of the fifth year an affidavit of use with the Patent Office. Revenue Ruling 55-158 holds that amounts spend in preparation and filing of an affidavit of use may not be deducted under 162(a) of the Code, but must be capitalized. Appellee has not suggested nor do we perceive any basis in logic or policy for treating legal fees incurred resisting a petition to cancel a trademark registration in a manner different from legal fees incurred avoiding the automatic cancellation under 15 U.S.C. § 1058. In both situations the benefits secured extend beyond the tax period during which the fees are paid out. Thus, regardless of the type of trademark expenses which may fall outside the ambit of Section 17(b)(2), it is clear that the legal costs of cancellation proceedings are not among them.

We conclude that the Internal Revenue Service properly classified the fees incident to the cancellation proceeding as a capital expenditure and the deficiency assessed on that basis was correct. Accordingly, the judgment of the district court is reversed and the case remanded with instructions to enter judgment in favor of the Government.

REVERSED.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FOURTH COURT

No. 73-1187

Order

(Filed October 26, 1973)

Upon the motion of the appellee, Georator Corporation, to amend and correct the conclusion of the opinion heretofore filed in this case, and counsel for the United States

having no objection thereto, it is ORDERED that the opinion be corrected and amended by deleting the last sentence on page 11, and in lieu thereof, concluding the opinion as follows:

"Accordingly, the judgment of the district court is reversed and the case remanded with instructions to enter judgment in favor of the plaintiff/appellee herein in the sum of $1,111.60 in taxes and $116.98 as assessed interest, or a total of $1,228.58, under the stipulations filed in the court below, in lieu of the judgment entered below for $11,278."

/s/ JOHN FIELD, JR.
United States Circuit Judge

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE FOURTH COURT

No. 73-1184

Order Denying Rehearing

(Filed December 26,1973)

Upon consideration of the appellee's petition for rehearing, with the concurrence and approval of the other members of the panel,

It is ORDERED and ADJUDGED that the petition for rehearing is denied.

/s/ JOHN FIELD, JR.
United States Circuit Judge

APPENDIX E

§ 162. Trade or business expenses

(a) In general.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

For purposes of the preceding sentence, the place of residence of a Member of Congress (including any Delegate and Resident Commissioner) within the State, congressional district, Territory, or possession which he represents in Congress shall be considered his home, but amounts expended by such Members within each taxable year for living expenses shall not be deductible for income tax purposes in excess of $3,000.

§ 177. Trademark and trade name expenditures

(a) Election to amortize.—Any trademark or trade name expenditure paid or incurred during a taxable year beginning after December 31, 1955, may, at the election of the taxpayer (made in accordance with regulations prescribed by the Secretary or his delegate), be treated as a deferred expense. In computing taxable income, all ex-

penditures paid or incurred during the taxable year which are so treated shall be allowed as a deduction ratably over such period of not less than 60 months (beginning with the first month in such taxable year) as may be selected by the taxpayer in making such election. The expenditures so treated are expenditures properly chargeable to capital account for purposes of section 1016(a) (1) (relating to adjustments to basis of property).

(b) Trademark and trade name expenditures defined.—For purposes of subsection (a), the term "trademark or trade name expenditure" means any expenditure which—

(1) is directly connected with the acquisition, protection, expansion, registration (Federal, State, or foreign), or defense of a trademark or trade name;

(2) is chargeable to capital account; and

(3) is not part of the consideration paid for a trademark, trade name, or business.

(c) Time for and scope of election.—The election provided by subsection (a) shall be made within the time prescribed by law (including extensions thereof) for filing the return for the taxable year during which the expenditure is paid or incurred. The period selected by the taxpayer under subsection (a) with respect to the expenditures paid or incurred during the taxable year which are treated as deferred expenses shall be adhered to in computing his taxable income for the taxable year for which the election is made and all subsequent years.

§ 1221. Capital asset defined

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the

inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

* * * * * * * * *

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by—

(A) a taxpayer whose personal efforts created such property,

(B) In the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis of such property in the hands of a taxpayer described in subpaargraph (A) or (B);

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